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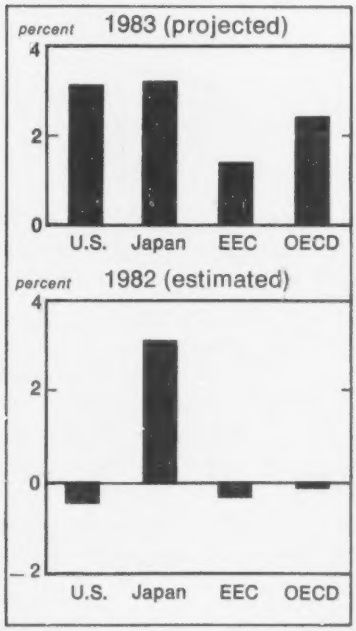
The World Economy in 1983—Progress, but Not Without Pain

The prospects for the world economy in the coming year are decidedly mixed. Although the short-run indicators in most industrialized economies are discouraging, a moderate recovery of aggregate OECD output in the course of the year is likely. The United States should show the quickest turnaround—perhaps as early as late winter or early spring—and will record the hardiest rebound in growth among the major industrialized countries. The outlook for the European economies is less optimistic, with recovery likely to be delayed until the second half of the year and slow to develop momentum. The prospects for growth in the developing countries differ widely by region. The growth performance of most Asian economies will not vary significantly from last year, but the outlook for many African and Latin American economies has taken a turn for the worse as a result of the dramatic change in the climate of international lending.

Projected economic growth in 1983 compared with 1982
(Change in real GNP, 4Q to 4Q)



The sharp decline in imports by the developing countries is one major element slowing recovery in the industrialized countries—reducing potential OECD growth this year by as much as one percentage point. A second negative force is the continuing global weakness in capital investment. Prospective improvements in capacity utilization and business profits are not likely to be sufficient to reverse the decline of investment in plant and equipment before 1984. Furthermore, concern that economic recovery will not bring about significantly lower government borrowing requirements—given current fiscal policies—may constrain the reduction of long-term interest rates.

Nonetheless, there are reasons for some optimism. Most important, monetary policy in the key industrialized countries has become relatively more expansionary. Interest rates have fallen sharply since mid-1982 and should continue to decline. Household balance sheets have improved markedly, and consumer spending should make strong gains by midyear, particularly in the United States. Residential construction in the major OECD economies appears likely to show significant growth, and a classic inventory rebuilding cycle is in the offing. Finally, the earlier fears of a major upset in the international financial system have been calmed by successful cooperation between official institutions and the international banking community in putting together refunding packages for those developing countries with severe liquidity problems. The global economy will show only moderate recovery in 1983, but its growth performance should be noticeably better than the sorry record of the year just past.

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WESTERN EUROPE

The hesitant recovery that was signaled in Western Europe at the start 1982 failed to materialize. The initial recovery in stock-building was followed by a further downturn in final demand as fiscal policies were tightened, consumer and investor confidence waned, and demand outside Europe continued to decline. By the third quarter, GNP in most countries was falling again. More recently, monetary policies have been eased, but interest rates remain high relative to Europe's declining inflation rates. Meanwhile, fiscal policy has been tightened yet again. Hopes for a 1983 recovery are now pinned on a further fall in interest rates and an economic upturn in the United States and Japan. These suggest, at best, a weak revival in the latter half of 1983—but the risks remain on the downside.

In the **United Kingdom,** inflation has fallen even faster than the most optimistic projections suggested; still, domestic output remains stubbornly low. With 1983 likely to see an election, the markets expect a moderately expansionary budget that will generate some 1.5% growth in GDP while keeping the average rate of inflation below 7%.

Short-term growth prospects in **France** are rather poor following the tightening of economic policy in mid-1982. It seems unlikely that real GDP will increase by more than 1% this year, about the same as 1982. The impact of price and wage controls will lower the average inflation rate to 11% from 12%. Weak domestic demand, coupled with some pickup in exports, may reduce the current-account deficit to FF 55 billion from FF 70 billion last year.

Switzerland's domestic demand is now very weak, in line with falling foreign sales. Preliminary estimates of 1982 real GDP suggest a decline of as much as 1.5%, with prospects of, at best, zero growth in 1983. Inflation will average around 4.5% and the current account will register a strong surplus of close to SF 10 billion.

Fiscal policy in **West Germany** has been tightened despite an election scheduled for March, and real wages look set to fall for the third consecutive year. Even with a second half recovery, real GNP is expected to show, at best, no growth for 1983 overall after about a 1% decline in 1982. Inflation should slow to some 3.5%—or less if the U.S. dollar weakens early in 1983—and the current account should continue in small surplus. The picture for the **Benelux** countries is much the same.

Italy continues to suffer from high inflation and a large balance-of-payments deficit. Hopes for an export-led recovery have not yet faded, but even so, real growth of less than 1% is likely after a flat performance in 1982. Inflation is likely to exceed the government's target of 13%, while the current-account deficit is forecast to narrow to some $5 billion as the terms of trade improve.

The **Scandinavian** economies are expected to grow a little faster than the European average, but at the cost of continuing inflationary pressures, which were increased by the round of devaluations last October.

WESTERN HEMISPHERE

Canada experienced its worst economic performance in recent history in 1982, with a real GNP decline of 4.5%-5% accompanied by inflation averaging more than 10%. Expectations are that 1983 will bring a small gain in real growth and a rate of price increase of about 8%.

In the Latin American-Caribbean area, 1982 was a year of falling output and big debt refinancings. Preliminary estimates of last year's regional GDP growth show a decline of at least 1%, making 1982 the worst year since these data have been compiled. The need for external debt amortizations and refinancings will have a continued pervasive influence on the region in 1983. The IMF, in conjunction with other international institutions and supported by the commercial banks, is assuming an increasingly predominant role and is likely to have a total of $16 billion of its own financial arrangements covering some 15 Latin American-Caribbean countries this year. Given the restrictive policies that the debt difficulties will require, plus continued lackluster world economic growth, further economic decline in the region in 1983 is inevitable—probably in the neighborhood of 2%.

Brazil's economy showed practically no growth last year. And in view of the demand restrictions accepted under its agreement with the IMF, little or no growth is expected in 1983. **Mexico** has also announced tough restraint measures that are likely to reverse 1982's 2% increase in GDP to as much as a 4% decline in 1983. Last year was **Argentina's** second

year of declining economic activity. However, there is some possibility of a small recovery in real GDP in 1983—even with an IMF stabilization program.

Among the Andean economies, **Venezuela, Colombia, Ecuador,** and **Peru** recorded extremely low levels of activity in 1982, while **Chile** suffered a huge 13% drop in output. The outlook for 1983 anticipates continued low growth—or even declines—in GDP, as all of these countries face policy-induced demand restraints and weak commodity prices. **Uruguay's** economy declined sharply in 1982 but a slight recovery could take place this year, while **Paraguay's** previous experience of high GDP growth is changing to a smaller—but still positive—economic advance in 1983.

For Central America, political and economic difficulties will continue to affect all countries, offering little hope that the low growth or declines of the past year will improve much. **Costa Rica** could show some strengthening under an IMF stabilization plan, however. **Panama** has managed to avoid many of the problems of Central America, but its growth has been adversely affected by the decline in international trade.

The Caribbean economies are all facing subdued conditions and rising concern over international earnings from commodities or tourism. **Trinidad and Tobago** will experience slower growth because of world oil price weakness. **Jamaica's** advance will be limited by the soft demand for bauxite. The **Dominican Republic** is undertaking an IMF program to finance its payments deficits, while the **Bahamas** has had to impose budgetary restrictions to offset lower revenues from tourism. **Puerto Rico** may pull out of its deep 1982 depression as the U.S. economy shows improvement. Even **Cuba** has not been spared the region's difficulties; its sugar-based economy will be under serious debt constraints in 1983.

ASIA-OCEANIA

In **Japan,** consumer spending—the main source of strength last year—will increase more moderately in 1983 as the public-sector wage freeze holds down private-sector wages. Consequently, any acceleration in real growth from the estimated 2.8% in 1982 will depend primarily on a pickup in external demand. The weak yen and recovery in the world economy suggest a boost in export sales. But high inventories of Japanese goods abroad and the rising tide of U.S. and European trade restrictions will moderate export growth. Thus, Japan's real growth is expected to increase only slightly to about 3%-3.5%, and the current-account surplus is projected to widen to $9-10 billion in 1983 from around $7.5 billion in 1982. Inflation is likely to accelerate to 3.5% from 3% last year, owing to expansionary monetary policy.

Prospects for Asia's newly industrialized countries (NICs) in 1983 depend on recovery in their OECD markets. If the turnaround in the OECD economies is delayed until the second half of the year, growth in the NICs will remain sluggish for most if not all of 1983. **South Korea's** growth rate is expected to be the highest at around 6%, while economic growth for **Taiwan** and **Singapore** should be in the 4%-5% range. Although **Hong Kong's** overall outlook remains clouded by the uncertainty over the China lease, exports should recover rapidly.

The Philippines has begun to benefit from lower interest rates on its external debt and from a slight recovery in commodity prices. If these trends continue, GDP growth could climb back to the 4%-5% range. **Thailand's** payments deficit has been declining, and while business activity is sluggish, the effects of the recession are moderate. As a result, 1983 GDP growth should be around 6%. **Malaysia's** current-account deficit for 1982 is estimated to have been over $3.5 billion, and GDP growth dropped to about 4%. This year is likely to be only slightly better, with growth around 5% and a current-account deficit just under $3 billion. **Indonesia** has suffered a sharp payments reversal, with a current-account deficit on the order of $7 billion expected for fiscal 1982-83 owing to disappointing oil revenues and a severe decline in commodity earnings. Because of this, some large capital projects may have to be cut back. Better balance in industrial growth and continuing agricultural success will sustain **China's** 1983 growth at 4.5%. Furthermore, imports should increase by more than 15%, given strong foreign-exchange reserves.

Australia's high wage structure and the low demand for its commodities continue to depress exports. Real output in fiscal 1982-83 will decline, and only a slow 1983-84 recovery is forecast. **New Zealand's** real GDP will rise 2% in the fiscal year beginning April 1, after falling more than 1% in the current year.

BEST AVAILABLE COPY

MIDDLE EAST-AFRICA

Depressed world demand for oil last year touched off a 17% decline in OPEC oil output and a significant drop in the average effective price. As a result, the OPEC current account swung to a deficit estimated at $5-10 billion from a surplus of $60 billion in 1981. Oil demand is projected to expand this year, but not strongly. Consequently, even if the oil price structure does not crack, the OPEC current account will be just balanced, at best, in 1983.

Saudi Arabia's oil output will remain depressed this year, so that a substantial budget deficit may result even if development outlay is curtailed. Economic activity in **Kuwait** will be constrained by the effects of the recent stock market difficulties, although corrective measures appear to have averted a major crisis. In the **UAE** and **Qatar** public-sector outlays will be restrained this year, but less so in **Oman** where more external borrowing is planned. Development expenditures in **Tunisia** will accelerate and more will be financed externally. **Morocco's** financial deficits will narrow from recent record levels, but Egypt's deficits will widen with the slowdown in the growth of export earnings; both countries will remain heavily dependent on external aid. **Iran,** by means of heavy price discounting, has bolstered oil exports and now faces a comfortable external financial position. In contrast, the enforced closure of **Iraq's** Arab Gulf oil-export outlets has caused a severe revenue loss, forcing cut-backs in development spending. **Algeria's** balance of payments has remained sound because of higher LNG and condensate sales and continued conservative spending. **Libya** has expanded oil exports rapidly by price cutting and is now beginning to reduce its accrued payments arrears. And in **Bahrain,** activity remains brisk thanks to new industrial and infrastructural projects. Meanwhile, **Jordan** has begun to suffer from a slowdown in aid payments. In **Israel,** inflation may average 130% in 1983 barring any new, well-defined policy initiatives.

Sub-Saharan Africa in 1982 saw a continuation of the declining trends in export revenues and agricultural output, coupled with rising external indebtedness. The resulting deterioration in debt-servicing capacity set in motion debt-rescheduling procedures in a number of countries —some of which had defaulted on previously rescheduled debt. **Nigeria** has had to retrench its ambitious development plans, partly as a result of lower oil revenues. **South Africa** may have passed the low point in its balance of payments—as gold prices have rebounded—but continues to suffer from economic stagnation. Oil exploration and development are proceeding in **Ivory Coast, Cameroon, Gabon, the Congo,** and **Angola,** with injections of much-needed foreign investment funds. However, for the majority of these countries, 1983 will bring recession-induced austerity measures, currency devaluations, and shrinking import volumes.

COMMODITIES

The modest recovery in OECD growth projected for 1983 and rising confidence that the recovery will strengthen in 1984 should sustain an increase in most commodity prices. However, the price rebound is projected to be limited. Continuing weakness in the machinery sector, buffers existing in present inventory levels and idle capacity, the moderation of inflation expectations, and continuing positive real interest rates will all act to moderate price increases among the industrial commodities. And for most agricultural commodities, the combination of increased capacity, higher yields, and stagnant demand have boosted stocks and will constrain any rise in prices in 1983.

The largest gains in commodity prices this year are expected in metals and minerals that suffered sharp declines in 1982. **Copper** prices are projected to rebound to around 80¢ per pound on average in 1983 from around 68¢ last year. The prices of other metals such as **nickel** and **zinc** will recover more slowly, since a strengthening of demand for these commodities depends critically on an upturn in OECD capital investment.

The last four months of 1982 saw a significant recovery in the prices of precious metals. **Gold** prices, triggered by fears over the possibility of major international financial disruptions, climbed to over $450 per ounce. Prices could rise further in 1983 but are just as likely to fall, given the foreign-exchange requirements of the principal gold-producing nations. **Silver** prices firmed markedly toward year-end 1982 and should average around $13 per ounce in 1983.

For **wheat,** a record U.S. harvest and good production results elsewhere—except in Australia —pushed market prices to a four-year low. A modest recovery in prices is possible in 1983 given a decline in North American production—partly stemming from the introduction of a new U.S. acreage reduction program. Continuing good harvests for U.S. **corn** and a partial recovery in Soviet **coarse grain** production have seriously depressed corn prices and reduced U.S. exports. Growth in consumption of coarse grains will be insufficient to reduce world stocks, so any price recovery will be modest. Despite a record harvest in China, world **rice** production in 1982-83 will decline because of rainfall problems in South Asia.

The production surge of recent years in **oilseeds and related products** is expected to continue, with the most rapid growth being in palm oil and rapeseed. A modest turnaround in **soybean** prices is forecast for 1983, but the prices for other vegetable oils are likely to decline by 3%-5%. **Coffee** prices are projected to fall in 1983, while a rebound in **cocoa** prices of perhaps 5%-7% appears likely. **Sugar** prices are expected to remain about 6¢-8¢ per pound on average in 1983, owing to price-support programs in the OECD and the competition from sweetener substitutes. Higher demand and projected declines in stocks should boost **cotton** prices by around 5% in 1983.

Latin America Bimonthly Survey of Business and Finance

COUNTRIES	CURRENT BUSINESS CONDITIONS	EXPORTS		GNP IN 1981		BALANCE OF PAYMENTS					MONEY AND BANKING							COUNTRIES
		6 months ending	change from year earlier	in billions of dollars	per capita	latest data	reserves (less gold) in million $	12-month change	months of imports covered	use of IMF credit, millions of dollars	current influences on payments	12-month changes: latest data	12-month changes: consumer prices	latest data	money supply(M1)	exchange rate in U.S. dollars December 29, 1982	change from year earlier	current monetary conditions	
Argentina	Agriculture and trade leading economic recovery but inflation is at a 200% annual rate.	June	— 7%	128.0	$4,547	Aug.	2,681	— 29%	3.3	0	Agreement reached on IMF program of $2 billion to help payments position.	Nov.	+206%	June	+140%	.000024	—83%	Interest rates rising.	Argentina
Bahamas	Increase in auto and gasoline taxes plus higher import duties imposed for budget needs.	June	— 1%	1.3	5,200	Oct.	126	— 1%	3.6	0	Debt-service payments decline.	Aug.	+ 6%	Aug.	+ 7%	Par	—	Bank liquidity rising.	Bahamas
Brazil	Real GDP expected to show zero growth in 1982 as result of industrial slowdown.	Oct.	—12%	284.8	3,343	July	6,160	+ 15%	3.5	0	IMF program for $4.8 billion approved.	Nov.	+ 95%	Oct.	+ 70%	.0042	—47%	Banks offering higher CD rates.	Brazil
Chile	Agriculture hard hit by economic recession and large debts.	Aug.	— 1%	35.3	3,126	Oct.	1,966	— 41%	5.9	11	Trade in surplus as imports decline.	Oct.	+ 16%	July	— 17%	.0130	—50%	Money supply falls as foreign reserves drop.	Chile
Colombia	Real GDP growth slows to 1.5% in 1982 as industry and exports decline.	Sept.	— 6%	37.3	1,399	Oct.	3,743	— 17%	8.3	0	Reserves drop as services income falls.	Sept.	+ 24%	Sept.	+ 25%	.0145	—28%	Government attempts to reduce interest rates.	Colombia
Costa Rica	Real GDP decline of 6% estimated for 1982; unemployment rising.	Aug.	—16%	5.0	2,200	Oct.	207	+105%	2.9	90	Imports reduced because of debt problems.	Aug.	+103%	June	+ 67%	.0245	—59%	Interest rates increased to capture savings.	Costa Rica
Dominican Rep.	Tax increase effort being introduced as part of IMF program.	Nov.	—30%	7.3	1,314	Oct.	53	— 74%	0.5	68	Government requests refinancing of arrears.	June	+ 8%	Aug.	+ 15%	Par	—	Central bank to limit credit growth.	Dominican Rep.
Ecuador	Real GDP growth down to 1.5% or less in 1982 owing to oil export decline.	July	— 6%	12.3	1,429	Aug.	365	— 47%	2.0	0	New restrictions placed on imports.	Aug.	+ 15%	May	+ 22%	.0302	— 3%	Credit to public sector reduced.	Ecuador
El Salvador	Foreign exchange shortage and low commodity prices cause GDP decline.	April	— 4%	3.5	701	Oct.	106	+ 49%	1.4	95	Trade deficit grows as exports decline.	June	+ 12%	July	+ 5%	.4032	0	Special government credit extended to business.	El Salvador
Jamaica	Economic growth slowing because of declining bauxite sales.	July	—29%	2.8	1,271	Sept.	116	+ 45%	1.0	574	USSR to purchase bauxite on seven-year basis.	July	+ 6%	July	+ 24%	.5600	— 2%	Large rise in domestic credit.	Jamaica
Mexico	Fiscal deficit to be cut to 8.5% of GDP in 1983 from 1982's 16.5%.	July	0	238.7	3,303	Feb.	2,243	— 28%	1.6	0	Peso allowed to float.	Oct.	+ 79%	Aug.	+ 42%	.0105	—73%	Interest rates raised as inflation rises.	Mexico
Panama	Government making greater effort to cut fiscal deficit through spending restraint.	June	—17%	3.8	2,027	Aug.	82	— 30%	0.6	77	Sugar exports down sharply.	Sept.	+ 5%	May	+ 8%	Par	—	Credit to government declines.	Panama
Paraguay	Depressed commodity prices and drop in construction activity slow economy.	Aug.	+40%	5.4	1,653	Oct.	697	— 10%	13.2	0	Exports to Brazil recently increased.	Feb.	+ 6%	Feb.	— 4%	.0079**	— 1%	Central bank credit reduced.	Paraguay
Peru	Public spending down, consumption cut by inflation; economy in recession.	June	+32%	21.0	1,160	June	1,444	+ 19%	5.4	571	Faster devaluation helps exports.	July	+ 62%	April	+ 46%	.0011	—52%	Credit to private sector increased.	Peru
Puerto Rico	Unemployment rate down slightly from 24% high of July-August.	Sept.	+ 4%	11.7	3,658	Oct.	11,203*	— 2%	16.0	—	Record trade surplus estimated for 1982.	Sept.	+ 1%	Oct.	+ 4%	Par	—	Loan-to-deposit ratio increases.	Puerto Rico
Trinidad & Tobago	Decline in oil and sugar production offset by expansionary fiscal policy.	June	—17%	7.1	5,930	Oct.	3,165	— 2%	10.8	0	Lower oil earnings produces trade deficit.	Aug.	+ 12%	July	+ 35%	.4167	0	Banks restraining credit growth.	Trinidad & Tobago
Uruguay	Foreign-exchange rate devalued in effort to aid export industries and tourism.	Aug.	—29%	10.9	3,711	Aug.	168	— 61%	1.7	92	Export rebates eliminated.	March	+ 22%	June	— 6%	.0340	—62%	Domestic credit is scarce.	Uruguay
Venezuela	Lower oil export earnings and cuts in public spending depress economy.	June	—19%	69.4	4,454	Oct.	6,875	— 11%	6.4	0	Import controls put on 355 products.	Sept.	+ 9%	July	+ 4%	.2329	0	Central bank expanding credit facilities.	Venezuela

*Commercial bank deposits

**imports and exports

World Interest Rates

market rates of Dec. 29, 1982; bond yields as of Dec. 24, 1982

in percent per annum	U.S.	Canada	Britain	Belgium	France	Germany	Italy	Netherlands	Switzerland	Japan
Central Bank Discount Rate	8.50	10.26	10.00 intervention rate	11.50	9.50	5.00	18.00 penalty rate 21.00	5.00	4.50	5.50
Day-to-Day Money	9.00	12.50	10.375	9.15	12.875	6.00	19.00	5.375	1.25 1-month Euro-Swiss fr. rate	6.875
Treasury Bills 91-day, Middle Rates	8.10	9.95	9.875	12.25	n. a.	n. a.	18.10 90 days	no dealing	no market	5.625 two-month
Commercial Paper prime, 3-month, asked	8.50 finance paper discount basis	10.15 finance paper 15% tax w/h	9.706	11.40 Certified	12.9375 Interbank	no market	no market	no market	no market	not traded
Bankers' Acceptances 3-month, asked	8.60	10.05 15% tax w/h	9.875	11.40 Certified	not traded	6.90	19.90	no market	3.625	no market
Government Bonds Long-term, new and old issues, average yield	10.69	12.00	10.82	8.54	14.71	7.82	19.45	8.04	4.27	7.91
Industrial Bonds prime, long-term, new and old issues, average yield	11.85 Aa Industrials	12.75	12.47	13.72	15.88	7.98	19.85	8.74	5.66	7.20
Bank Short-Term Rate to Best Borrowers (prime rate)	11.00	12.50	11.25	15.50	14.80	9.00	20.75 ⅛ qtrly fee on outstdng.	7.50	8.50	6.00
Bank Time Deposits 3-month	8.375 Cert. of Dep.	8.50	10.375	12.10	12.875	6.35	11.50	5.50 large deposits	3.00 residents only	3.75
Eurocurrencies 3-month, asked	9.4375	10.75	10.75	no market	25.00	6.1875	no market	5.375	3.50	7.00
Exchange Rates—in U.S.$ rates floating against the $	—	.8063	1.6212	.021906	.1489	.4216	.000734	.3806	.4999	.004296
Forward Exchange Cover 3-month, in percent p.a. *D* = discount, *P* = premium	—	1.191 *D*	1.209 *D*	5.186 *D*	15.581 *D*	3.321 *P*	16.894 *D*	4.204 *P*	5.681 *P*	2.328 *P*

Eurodollar Deposits
(London, interbank, bid)
December 29

7-day	10.125
1-month	9.625
3-month	9.375
6-month	9.6875

International Arbitrage
(3-month, hedged) + *in favor of U.S. dollars*

U.S.-U.K. Treasury Bills	−0.431
U.S.-Canada Treasury Bills	−0.285
U.S.-Canada Finance Co. Paper	−0.320
Eurodollars-U.K. Local Auth. Deposits	+0.084

Eurobonds
(average yield on recent straight debt issues)

U.S. Dollar Bonds	
7 yrs. and under	11.50
Over 7 yrs.	11.75
DM Bonds	
7 yrs. and under	7.75
Over 7 yrs.	8.50

Gold Price
London afternoon fixing
460.50
(per fine ounce)

The above interest rate quotations refer to the past week and may not be construed as offers by The Chase Manhattan Bank. The quotations for Bank Short-Term Rate to Best Customers, while including customary commissions, reflect neither possible other fees nor varying compensating balance requirements.

Current economic indicators of major industrial countries

	U.S.	Canada	Britain	France	Germany	Italy	Switzerland	Japan
Consumer prices*	(Nov.) 4.6	(Nov.) 9.8	(Nov.) 6.3	(Nov.) 9.4	(Nov.) 4.7	(Nov.) 16.7	(Nov.) 5.8	(Nov.) 2.3
Industrial production*	(Nov.) −7.3	(Aug.) −11.0	(Oct.) −0.5	(Oct.) −2.3	(Oct.) −6.5	(Oct.) −5.4	(June) −0.7	(Nov.) 2.3
Trade balance† *(billions of local currency units)*	(Nov.) −$4.09	(Oct.) C$1.68	(Nov.) £0.47	(Nov.) −FF6.90	(Nov.) DM4.85	(Oct.) −Lit.1,120	(Nov.) −SF0.44	(Nov.) ¥75
Money supply (M1)*	(Nov.) 8.8	(Oct.) 5.0	(Sept.) 14.4	(July) 14.7	(Sept.) 6.1	(July) 11.0	(Aug.) 5.4	(Aug.) 5.2
Velocity of money (M1)*	(Sept.) −6.5	(June) 1.5	(March) −5.3	(March)** 0.4	(June) 0	(June)** 7.6	n. a.	(June) −1.4
Reserves minus gold *($ million, change from previous month)*	(Oct.) 720	(Oct.) −185	(Oct.) 45	(Sept.) −949	(Oct.) 1,404	(Oct.) −1,226	(Oct.) −301	(Oct.) −1,149

* Percent change from 12 months earlier. ** based on GDP. † Figures are only for the month indicated.

BEST AVAILABLE

The U.S. Economic Outlook

The economic recession that began in August 1981 apparently continued throughout 1982, making it the longest of the eight recessions since World War II. Official statistics are not yet available, but total activity (real GNP) appears to have declined by about 1% between the fourth quarter of 1981 and the fourth quarter of 1982. While the recession may come to an end in early 1983, the pace of recovery is likely to be modest for the first few months. The unemployment rate—which was 8.5% in January 1982—may exceed 11% for a while before turning down later in the year.

Although the recession is continuing, some of the ingredients for recovery are now in place. The rate of price inflation is 5% or less—well under half the rate of just two years ago. The slowing of inflation, in turn, is one of the forces that have permitted interest rates to fall sharply (see next section). Before recovery can begin, however, it will be necessary for businesses to get inventories down from the excessive levels they reached last summer. Substantial cuts in industrial production in the latter part of 1982 indicate that this process is well under way. Once it is completed, probably by spring, employment and income should increase fast enough to stimulate consumer buying and thus support a general economic expansion.

Thanks to the decline of interest rates, one sector—residential construction—has already turned up. The last two years were the worst for housing construction in more than three decades. In 1981, construction was started on fewer than 1.1 million units of housing; as recently as 1977 and 1978, housing starts totaled about 2 million a year. The situation began to improve late last fall, and housing starts for 1982 are now estimated at 1.3-1.4 million units.

Aside from military expenditures, activity in other major sectors remains lackluster, at best. Consumer spending (about two-thirds of U.S. GNP) has been close to flat in real terms. Sales of such durable goods as automobiles and household appliances have been especially weak. Total auto sales last year, at less than 8 million units, were the lowest since 1964; sales of domestically produced cars were lower than in all but three of the years since the early 1950s. Automobile sales are generally expected to improve by 10%-15% in 1983.

The outlook for other sectors of the economy is less promising, especially for the first half of the year. Capital investment by business held up quite well during the early months of the recession, but has since turned sharply down. It fell at annual rates exceeding 10% in real terms during the second and third quarters of 1982. Orders, backlogs, and investment surveys all indicate that the decline will continue well into 1983, resulting from a squeeze on corporate liquidity and the lowest industrial operating rates since measurement began in the late 1940s. Investment is expected to be off by about 6% in real terms this year, following a drop of 4% in 1982. It should level off in the second half, but material improvement is unlikely before 1984. The other notably weak sector is foreign trade; it is discussed in detail on the next page.

The weakness in investment and foreign trade virtually assures that the pace of economic recovery in 1983 will be muted during its early stages, but the drag they exert on the economy should diminish late in the year. Total growth in real GNP may amount to about 2½% for 1983, measured fourth-quarter to fourth-quarter. Year over year, that would mean a gain of about 1.3%. The rate of price inflation is expected to show modest further improvement this year.

Lower interest rates likely

In general, interest rates will reach lower average levels this year than they did in 1982. This pattern, which will be most pronounced among short maturities, will result primarily from the more tame behavior of the monetary aggregates. To be sure, M1 will continue to be distorted by the influence of the new bank money-market deposit accounts, particularly early in the year. However, because both M1 and M2 finished 1982 above the top of their target ranges, next year's target growth paths—again probably 2½%-5½% for M1 and 6%-9% for M2—will apply to a higher base level. After this stock adjustment, money can resume its growth rate from the higher base. Moreover, because of the relatively weak economy and further improvement in inflation, the demand for money should be fairly soft, at least through the first half of the year.

Of course, interest-rate declines, precautionary buildups, or technical influences could spur periods of strong monetary growth. This would then leave the Federal Reserve with the difficult choice of either tightening prematurely and possibly threatening the chances of economic recovery or continuing to accommodate rapid money growth at the risk of raising the market's expectations of future inflation. In the absence of this, however, monetary pressures should be minimal until well into the second half of the year, when the recovery boosts transactions demand for money. As a result, interest rates should decline throughout most of 1983, with a modest backup in the fourth quarter.

Regarding financing activity, total credit-market borrowing will proceed at a somewhat stronger pace than the depressed 1982 levels. In general, borrowing in the first half of the year will be slower than in the second as government demands are seasonally weak. Moreover, business demands for expansionary funds—

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primarily to finance inventories—will not become significant until economic activity begins to recover strongly. The exception to this pattern will be mortgage activity, which, spurred by declines in mortgage rates and the slackening of home prices, will rise more rapidly in the first half of the year, as housing starts continue the climb they began late last year.

The business financing gap—investment and inventory outlays minus cash flow—will remain narrow early in the year, at about $20 billion, as after-tax profits rebound to some extent and investment activity remains moribund. Even after midyear, this pattern may not change markedly, despite inventory buildups, since the profit picture is expected to be somewhat brighter in the second half of the year. Low capacity-utilization rates still expected to be in effect make it doubtful that much new fixed investment activity will take place in 1983.

Initially, new funds raised in credit markets will be concentrated in new issues of bonds and common stocks. Given the uncertainty over Federal Reserve policy, the relatively low bond yields and high stock prices available at the end of the 1982 may be perceived as temporary phenomena that constitute a "window" for long-term financing opportunities. Indeed, much of the proceeds from these issues may be used for rebuilding liquidity, repaying bank loans, and retiring commercial-paper obligations. In the second half of the year, more recourse to short-term financing is likely, given the needs to finance inventory positions. The possible "fly in the ointment" here could show up in the event that–because of an interest-rate spike or some other reason—the recovery fails to materialize. Under these circumstances, a boom in short-term borrowing, similar to the distress borrowing that occurred in the first half of 1982, may take shape in the second half of the year.

U.S. current-account prospects

The strength of any world recovery will be the dominant influence on the U.S. external accounts in 1983. Domestic real economic growth is likely to be stronger than in the major foreign economies, tending to boost imports and hold down export growth. The consequent widening of the trade deficit will not be offset by an increase in the flow of services or financial assets, so the current-account deficit will also increase considerably. The strength of the dollar on the foreign-exchange markets in the past year will reinforce these trends. If the recent narrowing of real interest-rate differentials persists and the dollar's recent slide continues—both of which seem likely, although at slower rates—the trade balance as well as the current account could at least stabilize toward the end of 1983. Such a development would help ease the growing protectionist sentiments that threaten what promises to be an extremely fragile worldwide recovery.

At least partly because of an anemic U.S. recovery, real growth in the other OECD countries is projected to be only 1½%-2%, as much as 1% lower than U.S. growth. This growth differential implies that import demand in the United States will rise more rapidly than that of its trading partners. This will be particularly true since U.S. imports are concentrated in consumption items, for which demand normally rises rapidly during a recovery. Oil accounts for nearly 25% of the volume of U.S. imports. However, the current excess supply of oil is likely to continue to put downward pressure on prices, so that America's oil import bill may not rise at all. Imports of other items are unlikely to grow by more than 10% in value terms, or about 5% in volume terms, chiefly because of the subdued pace of the recovery. Furthermore, the current weakening of the dollar will begin to have an adverse impact on import prices and volume during the second half of the year.

Demand for American exports will also suffer as a result of the stronger economic growth in the United States relative to other industrialized nations. The demand for capital equipment, which constitutes about 40% of U.S. exports, is generally sluggish in the early stages of a recovery. Another 15%-20% of U.S. exports is made up of agricultural products, whose volume is dependent upon the vagaries of the weather both at home and abroad. U.S. farm exports are likely to increase in volume terms. However, continued low commodity prices may cause the value of agricultural exports to decline for the second year in a row.

All in all, the merchandise trade deficit could deteriorate to $60 billion in 1983 from nearly $40 billion in 1982. The surplus on services and remittances, although still quite large, is likely to shrink somewhat, as well. Thus, 1982's current-account deficit—estimated at about $2 billion—could swell upwards to $20 billion in 1983.

The slow worldwide recovery will intensify competition in many markets, with the possible consequence of severe trade conflicts. Squabbles over declining industries such as steel and automobiles have already spawned protectionist legislation in many of the OECD countries—for example, the proposed local-content requirement for American autos now being considered by the U.S. Congress. The combination of rising protectionism and the slow recovery is likely to hold the overall growth in the volume of world trade to less than 3%. Even with the U.S. trade balance deteriorating considerably, however, this projection does not leave much room for the United States to provide other nations of the world with export-led recoveries.